

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 302

April 23, 1965

SAVINGS AND LOAN ASSOCIATION: CHANGE TO BAD DEBT RESERVE METHOD

Syllabus:

Bank and Corporation Tax Reg. 24348 (a) promulgated the requirements governing the bad debt deduction for Savings and Loan Associations. It allows the use of either the specific charge-off method or the reserve method. With respect to the reserve method the regulation provides in paragraph (3) for the use of an average experience factor based on a 20-year period, either fixed or moving. The regulation then states:

The percentage so obtained, whichever factor is used, applied to loans outstanding at the close of the income year, determines the amount of the permissible reserve in the case of an association changing to the reserve method in such year.

The foregoing provision appears to be inconsistent with audit procedure which is that a taxpayer will be permitted to change from the specific charge-off method to the reserve method only on the basis that it spread over a ten-year period the amount provided for future losses in the year of change. The Savings and Loan Association regulation contains no such provision for a ten-year spread of the amount of permissible reserve in the year of change.

The provision of Reg. 24348(a), quoted above, allows a bad debt reserve in the year of change in the amount of the loss experience percentage applied to loans outstanding at the close of the year. This amount is allowed in full in the example which is set out in the regulation. Furthermore, the provision in the regulation for a ceiling on the reserve of three times the average loss rate, and the consequent application of the ceiling in the example set forth, assume the allowance of the full amount in the year of change. To apply audit procedure would complicate the application of the ceiling beyond the intent of the regulation.

It is concluded that the regulation be applied according to its terms, without reference to audit procedure.